No. 22,304

IN THE

United States Court of Appeals
For the Ninth Circuit

ASSOCIATED MACHINE (Formerly Associated Machine Shop), a Corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

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BRIEF FOR THE PETITIONER

OPINION BELOW.

This is a petition for review of the decision of the Tax Court of the United States (Harron, J.) filed June 15, 1967. The opinion of the Tax Court of the United States will be found at pages 76 through 98 of the Record, and is reported as *Associated Machine v. Commissioner*, 48 T.C. No. 32. (48 T.C. 318).

JURISDICTIONAL STATEMENT.

This appeal involves an alleged deficiency in the petitioner's Federal income tax for the calendar year ended December 31, 1959, in the amount of $43,088.91. Petitioner is a corporation, organized under the laws of the State of California, and the returns for all periods in question were filed with the District Director of Internal Revenue for the District of San Francisco, California. The petition for review was filed herein on September 15, 1967, and appears at pages 100 through 105 of the Record. This appeal is taken pursuant to Section 7482 of the Internal Revenue Code.

STATEMENT OF THE CASE.

The deficiency in question results from the disallowance of a deduction in the amount of $82,863.30 for the calendar year 1959, based upon a net operating loss sustained by the petitioner for the taxable year ended November 30, 1962, and carried back to the calendar year 1959.

The petitioner herein is the survivor of two California corporations which merged in 1960. The ultimate issue is whether the surviving corporation in a statutory merger may carry back a net operating loss as a deduction against income earned by a predecessor corporation where the merger results in *no change* in proprietory interest and *no change* or interruption in the business enterprise of the corporations involved.

The principal point upon which petitioner relies is that the merger of Associated Machine Shop and J & M Engineering was a reorganization described in Section 368(a)(1)(F) of the Internal Revenue Code, entitling the surviving corporation to carry back a net operating loss and apply it against the pre-merger income of the disappearing corporation under the authority of Section 381(b)(3) of the Internal Revenue Code.

STATEMENT OF FACTS.

On September 1, 1958, Joseph Schiavo caused the formation of a California corporation named Associated Machine Shop. He transferred to this corporation assets of a machine shop enterprise formerly operated by him as a sole proprietorship in exchange for all of the issued and outstanding stock of the corporation. On December 14, 1959, Joseph Schiavo formed a second corporation, J & M Engineering, for the purpose of engaging in fabrication and sheetmetal work. All of the issued and outstanding stock of this corporation was also issued to Joseph Schiavo. (Record, Volume I, pp. 12, 13, 79, 83, Volume II, pp. 37, 40, 42, 43).

Although Associated Machine Shop and J & M Engineering were formed to carry on separate lines of business, in fact both corporations carried on essentially the same line of business from December 14, 1959, to the date of merger. This resulted from the fact that the sheetmetal phase of the business did not develop sufficiently to be characterized as a separate business. (Record, Volume II, pp. 43, 44). The two corporations carried on their business in contiguous buildings (50 feet from each other) (Record, Volume II, pp. 45, 46) both of which were owned by Joseph Schiavo and leased to the respective corporations. Both corporations leased a substantial part of their equipment from Joseph Schiavo. (Record, Volume II, pp. 44-48).

Because J & M Engineering could not support itself in a separate sheetmetal operation, machine shop equipment was moved from the Associated Machine Shop building to the J & M Engineering building. Three-fourths of the equipment in the J & M building was machine shop equipment as opposed to sheetmetal and fabrication equipment. Also, a considerable number of Associated employees, primarily machinists, were switched over to J & M. Associated Machine furnished J & M with a buyer, estimator, salesmen, and all office, overhead, and accounting services. J & M did not pay and was never charged for *any* of these expenses, which were born *exclusively* by Associated. The corporations shared a tool crib and delivery trucks, and were covered under only one union contract. J & M did not maintain its own telephone or telephone listing. (Record, Volume II, pp. 49-56).

J & M was not able to obtain its own customers. (Record, Volume II, pp. 44-45). Its principal customer was Associated; its other customers were primarily Associated customers. Frequently both corporations worked on the same job orders. (Record, Volume II, pp. 54-56).

The articles of incorporation and by-laws of the two corporations were identical. The officers and directors of the two corporations were identical. (Record, Volume I, pp 3, 21-22, 30-31).

Because it was almost impossible to keep separate cost records for job orders involving both corporations, because the sheet metal work for which J & M En-

gineering was formed did not materialize, and because both corporations were engaged in the same line of business, Joseph Schiavo decided to merge them. (Record, Volume II, pp. 56-58). An agreement of merger was entered into on November 5, 1960, pursuant to which Associated Machine Shop was merged into J & M Engineering, and the name of J & M Engineering was changed to Associated Machine. The merger was completed December 1, 1960, and involved exchange of Associated Machine Shop stock for J & M Engineering (now Associated Machine) stock. The California Commissioner of Corporations determined that this exchange of securities did not require a permit to issue stock under California law. (Record, Volume I, pp. 14, 15, 16, 17, 49, 37-54).

After the merger, Associated Machine continued to operate both the machine shop and sheet metal business at the same physical location without any change in operations, employees, management, system of accounting, officers, directors, or stock ownership. At all times, Associated Machine Shop, J & M Engineering, and Associated Machine were completely owned, operated, and managed by Joseph Schiavo. (Record, Volume II, pp. 58, 59).

For its fiscal year ended November 30, 1962, Associated Machine sustained a net operating loss for Federal income tax purposes of $82,863.30. This net operating loss was carried back and allowed as a tentative carryback adjustment against Associated Machine Shop's income for the calendar year 1959, producing a refund of $43,088.91, plus interest. (Record, Volume I, pp. 19-20).

SUMMARY OF ARGUMENT.

The provisions of Section 381(b) of the Internal Revenue Code specifically allow the carryback of a post-merger net operating loss to offset pre-merger income only in situations where the merger is a reorganization described in Section 368(a)(1)(F), that is, a "mere change in identity, form, or place of organization, however effected." Petitioner contends that a statutory merger may, under appropriate circumstances, qualify as a so-called type "F" reorganization. In fact, the Internal Revenue Service has specifically ruled that a statutory merger as defined in Section 368(a)(1)(A) can also qualify as a type "F" reorganization. The Tax Court itself has reached the same conclusion, and has even gone so far as to disregard the forms of the reorganization entirely in allowing a loss carryback.

Petitioner contends that the question of application of the type "F" reorganization should be determined upon the basis of the following tests:

1. Continuity of Ownership - Does the reorganization result in any substantial change in the ownership of the entities involved?

2. Continuity of Business Enterprise - Does the reorganization involve any substantial change in the nature of the business?

In other words, the type "F" reorganization should be recognized as a logical extension of the well established "substance vs. form" doctrine. As will be pointed

out, this approach has in the past been advocated both by the Internal Revenue Service and the Tax Court, particularly in liquidation-reincorporation cases. It also has been and is being applied in the various other Courts, notably the Fifth Circuit.

The petitioner also contends that the Tax Court has erred in this and another recent case involving the same issue, *Estate of Stauffer*, 48 T.C. 277 (1967) (also on appeal to this Court) in attempting to limit the application of the "F" reorganization to changes in a single corporate entity. The apparent rationale for this is that Congress could not have intended otherwise, a totally unsupported conclusion; and that a contrary interpretation would produce administrative difficulties, which might justify the position of the Internal Revenue Service, but which can hardly serve as the basis for a *judicial* interpretation of a statute. Also, the finding of the Tax Court that the two corporations involved in this case operated separate businesses is *totally* unsupported by the record.

This case involves the merger of two corporations with identical ownership, operation, and business enterprise. The merger resulted in *no change* in this ownership, operation, and business enterprise. This clearly qualifies as a type "F" reorganization. To disallow this loss carryback is to penalize the taxpayer for the form of the reorganization, a pragmatic, administrative approach which is not a worthy basis for a judicial determination on the merits, and which should be repudiated by this Court.

SPECIFICATION OF ERRORS.

1. The Tax Court erred in refusing to allow the petitioner to carry back the net operating loss in the amount of $82,863.30 sustained in its taxable year ended November 30, 1962, to apply against the income of its predecessor, Associated Machine Shop, for the taxable year ended December 31, 1959.

2. The Tax Court erred in failing and refusing to hold and decide that the statutory merger of Associated Machine Shop and J & M Engineering in the year 1960 was a reorganization described in Section 368(a)-(1)(F); and that therefore a loss carryback would be allowed pursuant to Section 381(b)(1) of the Internal Revenue Code.

3. The Tax Court erred in holding that Section 368(a)(1)(F) could not apply to reorganization involving more than one corporate entity.

4. The Tax Court erred in holding that the merger of a parent and subsidiary corporation might qualify under Section 368(a)(1)(F) while the merger of a brother-sister corporation could not.

5. The Tax Court erred in repudiating its own prior decisions extending Section 368(a)(1)(F) to situations such as the one in this case.

6. The following findings of fact by the Tax Court are clearly erroneous:

a. That during the period December 14, 1959, to November 30, 1960, J & M was engaged in the active conduct of its own separate business. (Record, Volume I, p. 84).

b. That during the period December 14, 1959, to November 30, 1960, both Machine Shop and J & M maintained separate records, purchased materials, supplies, and services in their own names, and paid for them with their own funds. (Record, Volume I, p. 83).

c. That Machine Shop and J & M had separate directors' and shareholders' meetings, employees, and customers. (Record, Volume I, p. 84).

7. The Opinion and Decision of the Tax Court is contrary to law.

8. The Opinion and Decision of the Tax Court is not supported by the facts as set forth in the record.

ARGUMENT.

I.

UNDER THE PROVISIONS OF SECTION 381 (b) OF THE INTERNAL REVENUE CODE OF 1954, THE POST-MERGER NET OPERATING LOSS SUSTAINED BY ASSOCIATED MACHINE CAN BE CARRIED BACK TO OFFSET PRE-MERGER INCOME OF ASSOCIATED MACHINE SHOP IF THE MERGER OF ASSOCIATED MACHINE SHOP AND J & M ENGINEERING (NOW ASSOCIATED MACHINE) WAS A REORGANIZATION OF THE TYPE DESCRIBED IN SECTION 368 (a) (1) (F) OF THE INTERNAL REVENUE CODE OF 1954.

Section 381(b) of the Internal Revenue Code of 1954 defines the circumstances under which a net operating loss sustained by a corporation acquiring property in a reorganization could be allowed as a carryback against income of the distributing corporation:

> "(b) Operating Rules - Except in the case of an acquisition in connection with a reorganization described in subparagraph (F) of Section 368-(a)(1)-
>
> . . . .
>
> "(3) The corporation acquiring property in a distribution or transfer described in subsection (a) shall not be entitled to carry back a net operating loss for a taxable year ending after the date of distribution or transfer to a taxable year of the distributor or transferor corporation."

It is clear from the above that a loss carryback can be applied only in cases of corporate reorganizations defined in Section 368(a)(1)(F) as a "mere change in identity, form, or place of organization, however effected." The Commissioner concedes that loss carrybacks may be so allowed in Type F reorganizations in the Regulations at Section 1.381(b)-1(a)(2):

> "(2) Reorganizations under Section 368(a)-(1)(F). In the case of a reorganization under Section 368(a)(1)(F) (whether or not such reorganization also qualifies under any other provision of Section 368(a)(1)), the acquiring corporation shall be treated (for the purposes of section 381) just as the transferor corporation would have been treated if there had been no reorganization. Thus, the taxable year of the transferor corporation shall not end on the date of the transfer merely because of the transfer; a net operating loss of the acquiring corporation for any taxable year ending after the date of transfer shall be carried back in accordance with Section 172(b) in computing the taxable income of the transferor corporation for a taxable year ending before the date of transfer; and the tax attributes of the transferor corporation enumerated in Section 381(c) shall be taken into account as if there had been no reorganization."

It, therefore, must follow that if the statutory merger of Associated Machine Shop and J & M Engineering qualified as a Type (F) reorganization, the loss carryback claimed in this case is proper and should have been allowed.

Revenue Ruling 57-276 (CB 1957-1, 126) involved a statutory merger in which the disappearing corporation in one state merged into a new corporate entity

in another state. In holding that the reorganization qualified under both Sections 368(a)(1)(F) and 368(a)(1)(A), the ruling said:

> "It is believed it was not the intention of Congress in enacting Section 368(a)(1) of the Code to hold that just because a reorganization meets some other provision of Section 368(a)(1) the provisions of subparagraph (F) of that section are not complied with even though the transaction also qualifies under subparagraph (F). Taking a contrary view under the 1954 Code would, for all practical purposes, *defeat the provisions of Section* 381(*b*) of the Code, since many Section 368(a)-(1)(F) reorganizations meet some other provisions of Section 368(a)(1)." (Emphasis added).

Therefore, although the reorganization of Associated Machine Shop and J & M Engineering qualifies under Section 368(a)(1)(A), it could also qualify under Section 368(a)(1)(F). However, Revenue Ruling 57-276 left two questions unanswered:

(1) Will the same rule apply to mergers involving more than one-pre-existing corporation?

(2) What are the requirements for a reorganization to qualify under Section 368(a)(1)(F)?

The Service addressed itself to these problems in Revenue Ruling 58-422 (CB 1958-2, 145). The facts involved a parent and two subsidiary corporations, all viable, functioning entities, which merged into a new corporation in another state. On the date of the merger, the new corporate entity acquired all of the assets and assumed all the liabilities of the three predecessor

corporations. It issued common stock on a share for share basis for the common stock of the parent; the stock of the subsidiary was concelled. This was held to be a Type (F) reorganization, and the requirements for qualification of statutory mergers as Type (F) reorganizations in general were enunciated as follows:

> "Revenue Ruling 57-276, *supra,* is applicable in all cases where there is no change in the existing stockholders or change in the assets of the corporations involved."

In a very recent Revenue Ruling, 66-284 (1966-39, 8), the Commissioner reemphasized the position taken in both Revenue Rulings 57-276 and 58-422, applying the Type (F) reorganization rule to a statutory merger where a small percentage of shareholders dissented from the plan of merger and were paid for their stock.

In Petitioner's case, there was a statutory merger of two corporations wholly owned by the same person. There was no distribution of assets, no change in the nature of the assets or business, and no change in the nature of the enterprise. By the Commissioner's own definition, as set forth in the above rulings, the requirements for a Type (F) reorganization have been met.

II.

DECISIONS AND RULINGS APPLYING AND INTERPRETING SECTION 368 (a) (1) (F) OF THE 1954 INTERNAL REVENUE CODE AND ITS PREDECESSORS WOULD CLEARLY EXTEND THE TYPE "F" REORGANIZATION TO THE FACTS IN THIS CASE.

The question of what constitutes a "mere change in identity, form or place or organization, however effected" has not been the subject of frequent interpretation or litigation, at least until recently. However, the earlier decisions are enlightening. As early as 1923, the Supreme Court, in *Weiss v. Stearn*, 265 U.S. 242 (1924), held that a technical change for the purpose or reorganization in the technical ownership of an enterprise was not in itself a taxable event. A similar position was taken in I.T. 2392, VI-2 CB 17 (1927).

In *Ahles Realty Corporation v. Commissioner*, (C. C.A. 2d 1934) 71 F. 2d 1950, a corporation conveyed all of its property to a new entity. The new corporation issued stocks and bonds to the old corporation, which thereupon dissolved. The sole shareholder in the old corporation was the sole shareholder in the new corporation. This was held to be a "mere change in identity, form, or place of organization, however effected," as defined by Section 203(h)(1)(D) of the Revenue Act of 1926. In reaching this conclusion, the Court pointed out that there was "continuity of interest" as to both assets and ownership.

One of the important limits on the definition of what is now a Type (F) reorganization is found in *Helvering v. Southwest Corp.*, 315 U.S. 194 (1942), rehearing denied 315 U.S. 829 (1942), second petition for rehearing denied 316 U.S. 710 (1942). The facts were complicated, but basically involved the formation of a new corporation to take over the operations of a corporation in financial difficulty, with the creditors ending up owning most of the stock in the new corporation. The Supreme Court (at pages 202 and 203) said:

> ". . . a transaction which shifts the ownership of the proprietory interest in a corporation is hardly 'a mere change in identy, form, or place of organization'. . ."

A similar limitation on this type of reorganization was stated by the Tax Court in *Stollberg Hardware Co.*, 46 B.T.A. 788 (1942), (A.C.B. 1942-1, 16).

The above decisions indicate that historically, what is now Section 368(a)(1)(F) has been applied where the corporate reorganization has resulted in no change in the ownership of the enterprise, i.e., there was a requirement of "continuity of interest" as to the assets and the stockholders. They do *not* indicate any limitation on the use of the section based upon the *form* of reorganization or the number of entities involved. Petitioner submits that the facts of this case, involving no change in assets or ownership, clearly fit within the limitations the decisions have placed on Section 368(a)(1)(F).

III.

THE HOLDING OF THE FIFTH CIRCUIT IN DAVANT V. COMMISSIONER, WHICH WAS REPUDIATED BY THE TAX COURT, AND THE MORE RECENT DECISION OF A FEDERAL DISTRICT COURT IN HOLLIMAN V. UNITED STATES, REPRESENT CORRECT INTERPRETATIONS AND APPLICATIONS OF THE TYPE "F" REORGANIZATION IN LOSS CARRY-BACK CASES.

In its opinion, (Record, pp. 96, 97) the Tax Court concedes that the decision in *Davant v. Commissioner*, 366 F. 2d 874 (C.A. 5, 1966), modifying 43 T.C. 540 (1965), *cert. denied* 386 Y.S. 1022 (1967), is in direct conflict with the position taken by the Tax Court, and refuses to follow it. Thus there is *direct case authority* for the position taken by Petitioner here.

The *Davant* case involved brother-sister corporations ("Water" and "Warehouse") with identical shareholders, and each in a separate, active business. Through a relatively complicated transaction, one of the two corporations acquired all of the assets of the other. There was no change in ownership or business enterprise, but there was a distribution of $900,000 to shareholders.

The Tax Court was faced with the issue of whether or not the transaction was either a type "D" or type "F" reorganization (or possibly both). It concluded that a type "D" reorganization was involved; and therefore did not consider the type "F" argument. Al-

though the Government abandoned the type "F" argument on appeal, the Fifth Circuit, virtually on its own, decided the appeal primarily upon the application of Section 368(a)(1)(F) to the transaction. The Court (pp. 883-884) said:

> "A section 368(a)(1)(F) reorganization is defined as 'a mere change in identity, form, or place of organization, however, effected.' Since the Tax Court held that this transaction was a (D) reorganization, it apparently believed that is was unnecessary to decide the (F) question. In the past, type (F) reorganizations have overlapped with type (A), (C) and (D) reorganizations. For this reason this provision has received almost no administrative or judicial attention. It is true that a substantial shift in the proprietory interest in a corporation accompanying a reorganization can hardly be characterized as a mere change in identity or form. *Helvering v. Southwest Consolidated Corp.*, 315 U.S. 194 (1942).
>
> "The term 'mere change in identity (or) form' obviously refers to a situation which represent a mere change in *form* as opposed to a change in substance. Whatever the outer limits of section 368(a)(1)(F), it can clearly be applied where the corporate enterprise continues uninterrupted, except for a distribution of some liquid assets or cash. Under such circumstances, there is a change of corporate vehicles but not a change in substance. If Water had no assets of its own prior to the transfer of Warehouse's operating assets to it, could we say that Water was any more than the *alter ego* of Warehouse? The answer is no. The fact that Water already had other assets that were vertically intergrated with Warehouse's assets does not change the fact that Water was Warehouse's *alter ego*. Viewed in this way, it can make no practical difference whether the operating assets were held by Water or Warehouse, and

> a shift between them is a mere change in identity or form. At least where there is a complete identity of shareholders and their proprietory interests, as here, we hold that the type of transaction involved is a type (F) reorganization."

As will be noted, the facts in this case clearly establish that the same concept of *alter ego* or identity of interest should be applied in this case. Nor does the Tax Court deny it. Acceptance of the Fifth Circuit view requires reversal of the Tax Court in this case.

In a very recent case, a Federal District Court in Alabama followed the *Davant* opinion in *Holliman v. U.S.*, (U.S. Dist. Court, So. Dist. Ala., So. Div. 67-2 U.S.T.C. paragraph 9737). Although that case is factually distinguishable from Petitioner's, the following comments on the law by that Court are illuminating:

> "The Court finds that the arrangement was clearly an "F" reorganization within the meaning of Section 368(a)(1)(F). There was a change of vehicle but not of substance." (P. 85, 473).

The Alabama Court also cited with approval, *Davant*, *Ahles Realty Corporation v. Commissioner*, *supra*, and *Hyman T. Berghash*, 43 T.C. 743 (1965). Based upon these decisions, the Court concluded that an "F" reorganization was involved upon the following facts:

> "Here we have the same stockholders owning the old and the new company. We have the same assets. We have the same liabilities except for the scaled down demands of common creditors. And even as to these the new corporation agreed that if it failed to pay the installment parts of their respective debts the common creditors were free to advance claims for the full amounts owing

should there be a subsequent bankruptcy. The changes made were insignificant." (P. 85, 474).

On the bases of the foregoing, refunds based upon less carrybacks were allowed to the Trustee in bankruptcy of the successor corporation.

IV.

DECISIONS AND RULINGS APPLYING SECTION 368 (a) (1) (F) TO LIQUIDATION-REINCORPORATION CASES, PARTICULARLY THOSE HANDED DOWN BY THE TAX COURT, CLEARLY EXTEND THE TYPE "F" REORGANIZATION TO THE FACTS IN THIS CASE.

The application of Section 368(a)(1)(F) to the complex area of liquidation-reincorporations apparently started with Revenue Ruling 61-156, (CB 1961-2, 62), where it was applied to a sale by a corporation of all of its assets to a newly organized corporation followed by liquidation of the old corporation under Section 331 or 337 of the Internal Revenue Code. The facts in that ruling indicated that the shareholders in the old corporation owned only 45% of the stock in the new corporation.

The Tax Court has considered the application of the type "F" reorganization in a variety of liquidation-reincorporation cases. Examples are: *Joseph C. Gallagher*, 39 T.C. 144 (1962) (A. and N.A. CB 1964-2,

5); *Book Production Industries, Inc.,* (T.C. Memo 1965-65) 24 T.C.M. 339; *Reef Corporation,* (T.C. Memo 1965-72) 24 T.C.M. 379; *Estate of James F. Suter,* 29 T.C. 244 (1957). This Court has also considered it in at least one case, *Moffat et. al. v. Commissioner,* (C.A. 9th, 1966) 363 F. 2d 262.

In its opinion in our case (Record, Volume I, pp. 94-95), the Tax Court emphasized a position that the type "F" reorganization applies only to the "simplest and least significant of corporate changes." Yet in all of the cases above, the Government was strongly urging application of the section to a variety of situations, and the Tax Court has seriously considering so applying it. The tests applied by the Tax Court in those cases were not the *number* of corporate entities involved, or the *form* of the the transaction. The Court epplied basically two tests: (1) was there a substantial shift in proprietory interests, and (2) was there a substantial change in the nature of the business enterprise. Petitioner urges this Court to apply these tests used by the Tax Court to this case.

The culmination of application of Section 368(a)-(1)(F) to liquidation-reincorporation cases in the Tax Court was its decision in *Pridemark, Inc.,* 42 T.C. 510 (1964). As the case was analyzed by the Tax Court in this case (Record, Volume I, pp. 20-21), *Pridemark* involved three corporations basically owned by the same individual. Two of the corporations were dissolved, and its assets distributed to the shareholder. About a year later, he caused the formation of a new corporation, and used the assets of the dissolved cor-

porations to purchase all of the stock in the new corporation. The successor corporation engaged in the same business enterprise as its predecessors. The Tax Court held that this series of transaction constituted a type "F" reorganization, even though it involved *two separate* and *distinct* corporate entities reorganizing into *one.* The decision was reversed by the Court of Appeals for the 4th Circuit, *Pridemark v. Commissioner,* (C.A. 4th, 1965) 345 F. 2d 35, which based this decision largely on the lapse of time between dissolution of the old corporations and formation of the new one, and, as the Tax Court opinion points out, *did not* decide whether or not a type "F" reorganization could have been involved.

The Tax Court has of course conceded that its decision in this case and the *Stauffer* case are inconsistant with the *Pridemark* case. In *Stauffer,* the Tax Court went so far as to make the following statement (P. 218):

> "The case arose in the difficult area of liquidation-reincorporation, and this Court held that there had been an "F" reorganization. The briefs on this issue were skimpy, and it is obvious that the Court did not have the benefit of a presentation of materials like the one before us. . . . We think our decision in *Pridemark* was wrong . . ."

Petitioner suggests that if the Tax Court will reverse its own position on such an important area of statutory interpretation so easily, that position has little authority insofar as the decision of this Court is concerned. That lack of consistancy in application of Section 368-(a)(1)(F) will be discussed in detail in another sec-

tion of this brief. At this point, it should be sufficient to point out that *Pridemark* involved a situation where application of the type "F" reorganization was favorable to the Government position, i.e., the liquidation-reincorporation. Is it significant that where the shoe is on the other foot, and application of the Section is to the detrement of the Government's position, a different interpretation follows?

V.

THE BASIC ERROR COMMITTED BY THE TAX COURT IN ADOPTING AN INCORRECT DEFINITION AND INTERPRETATION OF SECTION 368 (a) (1) (F) IS BEST ILLUSTRATED BY ITS INABILITY TO APPLY THAT DEFINITION AND INTERPRETATION IN A SUBSEQUENT DECISION, WHEREIN THE TAX COURT INSTEAD INVENTED A COMPLETELY NEW FORM OF REORGANIZATION TO REPLACE IT.

In *Casco Products Corp.*, 49 T.C. No. 5 (1967), the owner of 91% of the stock in a corporation called Old Casco, who had been unsuccessful in redeeming the remaining 9%, formed a second corporation, called New Casco, took all of its stock, then merged the two corporations, thus effectively squeezing out the minority shareholders. New Casco was allowed to carry back its net operating loss across the line of the merger to apply against the income of Old Casco, *without the*

benefit of any of the provisions of Section 368 (*a*)-(1)(*A*) *through* (*F*). The Court expressly *refused* to indicate whether the merger qualified as a type "F" reorganization, with the following statement (P. 26):

> "Thus, both parties invite us to engage in an interpretative exercise as to the scope of section 368(a)(1)(F) and the relationship between sections 381(b) and 172. We decline the invitation to navigate these treacherous shoals. See *Reef Corporation v. Commissioner* . . . affirming in part and reversing as to the "F" reorganization issue a Memorandum Opinion of this Court: *Estate of Bernard H. Stauffer* . . . , *Associated Machine,* . . . *Dunlap & Associates* . . ."

The Court went on to hold that the merger was only a "legal technique" to freeze out minority shareholders, and did *not* have to be treated as a reorganization for tax purposes. This amazing extension of "form vs. substance," which all Courts, including the Tax Court, have considered to be the basis of the type "F" reorganization, has created a new form of reorganization, which petitioner characterizes as the type "X" reorganization.

Would the creation of a type "X" reorganization been necessary if the Tax Court had not previously failed to properly apply and interpret the type "F" reorganization? Petitioner thinks not. Petitioner submits that the Tax Court has hamstrung itself by its unfortunate decisions in the *Stauffer* case and petitioner's case. This point is further emphasized by the fact *four judges* dissented in the *Casco* decision on the basis that Section 368(a)(1)(F) should have been considered under the facts.

Petitioner submits that the reason the Tax Court refused to navigate the treacherous shoals referred to in *Casco* is that the Court itself created these dangers by its decisions in *Stauffer* and *Associated Machine.* A reversal by this Court will aid in removing these impediments to logical and reasonable interpretation and application of the statutes. It may even allow the Tax Court to eliminate its type "X" reorganization.

VI.

THE ATTEMPT OF THE TAX COURT TO LIMIT APPLICATION OF SECTION 368 (a) (1) (F) TO CHANGES WITHIN A SINGLE CORPORATE ENTITY IS WHOLLY WITHOUT MERIT.

In both the Tax Court opinion in this case (Record, Volume I, pp. 91 and 92, and its opinion in *Estate of Bernard H. Stauffer, supra*, the Court relies heavily upon the argument that Congress did not "intend" Section 368(a)(1)(F) to apply to reorganization involving more than one corporate entity. The statutory basis for this is the use of the singular word "corporation" in Section 202(c)(2) of the 1921 Revenue Act, predecessor of Section 368(a)(1)(F). All reorganization provisions are in the singular, and the full text of Section 202(c)(2) of the Revenue Act of 1921, which was *not* printed in full in the opinion, begins as follows:

> "When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization . . ."

The use of the phrase "one or more" certainly modifies the later use of the word "corporation." A parallel can be found in the provisions of Section 381(b) already quoted herein, which refer to a *transferor* and *acquiring* without in any way drawing a distinction between one or another of the types of reorganizations described in Section 368(a)(1). Petitioner could of course argue that the reference to a "transferor corporation" and "acquiring corporation" as will be found in Section 381(b) or Regulations Section 1.381(b)-1(a)(2) *infra*, proves that at least two corporations are always involved in "F" reorganizations, but this would be as fallacious as the Tax Court's conclusion that the use of the singular word "corporation" in 1921 through 1924 proves that *no more than one* corporation could be involved in a type "F" reorganization in 1968.

VII.

IN ATTEMPTING TO LIMIT THE APPLICATION AND DEFINITION OF SECTION 368 (a) (1) (F), AND THEREBY RESTRICTING THE AVAILABILITY OF THE CARRYBACK PREVILEGE, THE TAX COURT IS ACTING EXACTLY CONTRARY TO CONGRESSIONAL INTENT.

Not only has the Tax Court failed to properly interpret Congressional intent, it is asserting a position which is completely contrary to Congressional intent. The intent of Congress in enacting Sections 381 and 382 of the Internal Revenue Code of 1954 was expressed in the Senate Finance Committee Report (S. Rep. No. 1622, 83 Cong. 2nd Sess. 52) as follows:

> "Present practice rests on court-made law which is uncertain and frequently contradictory. Your committee agrees that whether or not the items carry over should be based upon *economic realities* rather than upon such artificialities as the legal form of the reorganization." (Emphasis added).

The Supreme Court and the Tax Court has interpreted the purposes of the reorganization statutes prior to 1954 in exactly the same manner, i.e., The considerations underlying the reorganization provisions are *not* cast in terms of form but of substance. *Bazley v. Commissioner* (1947) 331 U.S. 737.

The concept has also been well expressed in *F. C. Donovan, Inc. v. U.S.* (C.A. 1st, 1958) 261 F. 2d 470. This was a case wherein the Circuit Court allowed the less carryback in a parent-subsidiary merger situa-

tion. The Court applied the "economic business identity" test first enunciated in *Newmarket Manufacturing Co.* (C.A. 1st, 1956) 233 F. 2d 493, Rev'g and Rem'g 130 F. Supp. 706, *Cert. Den.* 353 U.S. 983 as follows: (P. 472)

> "The government argues, therefore, that the *Newmarket* case is not controlling here, where more than one business was involved. But we thought we had made it clear enough in the *Newmarket* case what we took to be of paramount importance, that the ownership and all other practically important attributes of the business which suffered the loss in 1952 and the business which had earned income in the previous year were unchanged. This is also true in the present case. It was in that context that we referred to the congressional desire, in enacting the carry-back privilege, to bring stability to the tax burden of 'a business with alternating profit and loss.' (233 F. 2d at page 497). And we thought that Congress must have had in mind, in this connection, the burden not of an artificial legal entity called a corporation but 'that of the human beings doing business behind the corporate facade and who, alone, actually feel the pinch of taxation'."

It is also significant to note that prior to the 1954 Internal Revenue Code, less carrybacks and carryovers were allowed only in the case of statutory mergers or consolidations. I.R.S. Section 122 (1939); *New Colonial Ice Co. v. Helvering*, (1934) 292 U.S. 435; *Newmarket Mfg. Co. v. United States, supra.* In referring to enactment of Sections 381 and 382 in 1954, the Senate Finance Committee report contained the following:

> "The new rules enable the successor corporation to step into the 'tax shoes' of its predecessor cor-

> poration without necessarily conforming to artificial regal requirements which now exist under court-made law. Tax results of liquidations or reorganizations are thereby made to depend less upon the form of the transaction than upon the economic integration of *two or more* separate businesses into a unified business enterprise." (Emphasis added). S. Rep. No. 1622, 83rd Cong. 2nd Sess. 52.

The failure of the Tax Court to properly read Congressional intent is best illustrated by the above report, which makes the following very telling points:

1. The use of the singular "predecessor corporation" and "successor corporation" in referring to all forms of reorganizations, not just a type "F" reorganization.

2. The express reference to an integration of two or more separate businesses into a unified business enterprise.

3. The specific reference to "form" vs. "substance" and the specific statement that the tax effects of the reorganization should not be based upon its "form".

Furthermore, the basic carryover and carryback provision, Section 122(b) of the 1939 Internal Revenue ode, was amended by the enactment of Section 172 of the 1954 Internal Revenue Code by eliminating the reference to "the taxpayer" who has a net operating loss being able to carry it forward or to *carry it back*. In *Maxwell Hardware Company* (C.A. 9th, 1965) 343 F. 2d 713, reversing 41 T.C. 386 (1964), this Court interpreted the new language of Section 172 as eliminating the old "same taxpayer" rule.

In summary, the Tax Court has completely erred in its interpretation of Congressional intent for the following reasons:

1. The use of the singular form is common to all statutory language pertaining to reorganizations.

2. In any case, Congressional intent should be read with reference to the 1954 Internal Revenue Code, which completely revised prior rules relating to reorganizations and loss carryovers and carrybacks.

3. The clear intent of Congress in 1954 was to *liberalize* the rules pertaining to loss carryovers and carrybacks, and to cast the reorganization provisions in terms of economic realities rather than legal forms of organizations.

VIII.

THE TAX COURT'S LIMITED APPLICATION OF SECTION 368 (a) (1) (F) TO CHANGES IN A SINGLE CORPORATE ENTITY CANNOT BE RECONCILED WITH THE APPARENT EXCEPTION FOR REORGANIZATION INVOLVING PARENT-SUBSIDIARY CORPORATIONS.

As we have just seen, the Tax Court relies very heavily upon so-called "Congressional Intent" to restrict the type "F" reorganization to changes in single corporate entities. Yet, in the *Associated Machine* opin-

ion, the Court is able to conclude that mergers of parent-subsidiary corporations may qualify under Section 368(a) (1) (F). As the Tax Court stated (Record, Volume I, p. 97):

> "The theory behind this distinction is that if a parent and subsidiary can file a consolidated return and benefit from the carryback provisions of Section 381(b), there is little reason to deny the same parent and subsidiary the right to effectuate the same thing another way—by merging on into the other or both into a newly formed corporation."

But what does this have to do with Congressional intent? How can the Tax Court in all good sense first argue that the statute was intended to be limited to a single entity, then blandly apply it to multiple entities, on the illogical basis that the multiple entities could have filed consolidated returns and accomplished the same thing? (Since consolidated returns are not at issue here, petitioner will refrain from discussing the obvious fallicies in the Court's statement that a reorganization does not differ in any material respect from filing consolidated returns).

The purpose of the corporate reorganizations is not to give corporations a choice between filing consolidated erturns and reorganizing corporations. The privilege of filing consolidated returns in no way affects the definitions in Section 368(a)(1). The attempts by the Tax Court to distinguish Revenue Ruling 58-422 on the basis that it applies only to parent-subsidiary corporations must be repudiated.

IX.

THE DECISION OF THE TAX COURT IN THIS CASE IS INCONSISTENT WITH ITS DECISIONS INTERPRETING SECTION 368 (a) (1) (F), INCLUDING A DECISION HANDED DOWN AS RECENTLY AS FEBRUARY, 1967.

The confused reasoning of the Tax Court in this area is well illustrated by its own decisions involving the type "F" reorganization. An excellent example is of course *Pridemark*, which the Court could not circumvent, and had to overrule. But there are other Tax Court decisions which were not overruled. For example, in *Joseph C. Gallagher*, 39 T.C. 144 (1962); *Book Production Industries, Inc.*, 24 T.C.M. 339 (1965); *Reef Corporation*, 24 T.C.M. 379 (1965) aff'd. (5th Cir. 1966) 368 F. 2d 125, cert. den. 386 U.S. 1018; *Hyman H. Berghash*, 43 T.C. 743 (1965) aff'd. (2nd Cir. 1966) 361 F. 2d 257; *Turner Advertising of Kentucky, Inc.*, 25 T.C.M. 532 (1966) and *Dunlap & Associates, Inc.*, 47 T.C. 542 (1967), all involved the question of application of Section 368(a)(1)(F). In *none* of these cases, most of which involved liquidation-reincorporation, did the Tax Court indicate that the number of entities or the form of the reorganization were of any significance. The Court instead applied tests of economic reality. Was there a shift of proprietory interest? Was there continuity of business enterprise? These are the tests which the same Court has now abandoned in favor of tests based upon form, not substance.

X.

IN ADMITTING THAT ITS INTERPRETATION OF SECTION 368 (a) (1) (F) WAS MATERIALLY INFLUENCED BY DIFFICULTIES OF ADMINISTRATION AND APPLICATION WHICH WOULD RESULT FROM AN INTERPRETATION MORE FAVORABLE TO THE TAXPAYER, THE TAX COURT ABDICATED ITS JUDICIAL FUNCTION.

Although hesitant to present this argument, the Petitioner is forced to conclude that the Tax Court was unduly influenced by respondent's arguments that application of Section 368(a)(1)(F) to reorganizations involving multiple corporations would result in administrative difficulties for the Internal Revenue Service. Although this point was not specifically alluded to in the Court's opinion in this case, it was in the *Stauffer* decision, which was cited with approval in *Associated Machine*. The illuminating and disturbing language employed in *Stauffer* includes the following: (P. 218).

> "Moreover, if several predecessors can be involved in an "F" reorganization difficult problems would arise as to which predecessor or whether all predecessors taken together may be taken into account in determining whether the complex requirements of . . . Section 1244 have been satisfied."

> "Unless we follow the obviously intended "one corporation" reading of the "F" reorganization, we would be faced with a difficult problem for which no solution is provided in the Code or regulations."
>
> "The Code is an extraordinarily complex and sensitive instrument, and we should be careful not to give an interpretation to one provision that would generate unintended difficulties in respect of other provisions, unless such interpretation is clearly called for by the statute itself."

This last quoted paragraph is *totally extraordinary.* Wherein does it contain any reference to the rights of the taxpayers to uniform application of the revenue laws, the concept of reasonable interpretation of statutes, and the hardships such rigid interpretations might impose upon taxpayers? Does the Tax Court exist as a forum for disputes between the taxpayers and the Treasury Department, or an administrative arm of the Treasury Department? Petitioner calls upon this Court to repudiate this unfortunate language, with the hope that the Tax Court will some day also repudiate it.

XI.

THE "UNINTENDED DIFFICULTIES" USED BY THE TAX COURT AS A BASIS FOR REFUSING TO BROADLY INTERPRET SECTION 368 (a) (1) (F) ARE NON-EXISTENT; THERE IS AMPLE AUTHORITY AND PRECEDENT FOR CARRYING A NET OPERATING LOSS BACK ACROSS THE LINE OF A CORPORATE MERGER, INCLUDING THAT FOUND IN A RULING OF THE INTERNAL REVENUE SERVICE.

Although Petitioner completely rejects the Tax Court's use of administrative convenience as a basis for statutory interpretations, Petitioner also contends that the so-called "unintended difficulties" envisioned by the Court are not insurmountable. It is true that neither Section 172 nor Section 381(b) provide operating rules to cover the situation before the Court. But these sections contain no rules at all pertaining to loss carrybacks, and the failure of the Commissioner to issue interpretative rulings and regulations certainly does not prove the point.

The 1939 Internal Revenue Code also contained no operating rules for loss carrybacks across the lines of corporate mergers, nor did the regulations thereunder. However, there was ample case authority under the 1939 Code for such carrybacks. *F. C. Donovan, Inc. v. U. S.*, *supra*, involved the merger of an active subsidiary into an active pertinent corporation. *Moldit, Inc. v. Jarecki*, (D.C.N.D. Ill. 1953) 45 Aftr. 1014, involved a survivor corporation which was allowed to carryback a loss against the income of *two* pred-

ecessor corporations. *Koppers Company v. United States* (CT. CL. 1955) 134 F. Supp. 290, allowed a carryback of an unused excess profits tax credit to a merged group of corporations which had filed consolidated returns.

Recognizing the validity of loss carrybacks to apply against premerger income of constituent corporations, and seeing the necessity to formulate some rules therefor, the Commissioner issued Revenue Ruling 59-395 (C.B. 1959-2, 475), which contains the following language (at pp. 478-479):

> "While on the basis of the particular facts before it in the *Libson* case a carry-over of a net operating loss was there denied, it is the opinion of the Internal Revenue Service that, in view of the principles enunciated and the decisions cited by the Court in that case, a different result would be warranted under the 1939 Code where a carry-over across the line of a statutory merger would result in application of either premerger losses or unused excess profits credits of an absorbed constituent corporation to offset income derived by the resultant corporation from the same business by which the loss was sustained or the credit acquired. For the same reasons, *carry-backs of net operating losses* and unused excess profits credits of the resultant corporation attributable to absorbed constituent corporations would appear to be properly allowable, to the extent that they offset premerger income of such constituent corporations, in determining the tax liability to which the resultant corporation has succeeded. . . .
>
> "Accordingly, absent any evasion or avoidance of tax within the purview of Section 129 or other provisions of the 1939 Code, with respect to statutory mergers and consolidations the tax treatment of which is determined under such code, it is held

> that . . . the portion of the net operating losses and unused excess profits credits attributable to the assets acquired by the resultant corporation from an absorbed constituent and used in continuing the prefusion business of such absorbed constituent, *may be carried back*, to the extent that they offset the prefusion income of the absorbed constituent, in determining, the tax liability to which the resultant corporation has succeeded." (Emphasis added).

Although this ruling was applicable to pre-1954 Code years, Petitioner contends that it points the way to the solutions to the "unintended difficulties" envisioned by the Tax Court in not allowing the loss carrybacks. The allocation referred to in that ruling could be amplified by the Commissioner to produce ruling or regulations which would clearly set out the methods to be used in making the offset of postmerger losses against premerger income. The difficulties are hardly insurmountable.

There is in fact ample precedent for the type of rulings or regulations contemplated by Petitioner. An excellent example will be found in Regulations Section 1.172-7 relating to joint returns of husband and wife, covering the carryback of a net operating loss from a joint return year to another joint return year or to separate returns of the spouses; as well as the carryback of a net operating loss from a separate return year to a joint or separate return year. The regulations under Section 381, notably Regulations Sections 1.381(c)(1)-1(d) through 1.381(c)(1)-1(h), pertain to problems of loss carryovers no more difficult than the problems of carrybacks which would result from this case.

XII.

A DECISION FAVORABLE TO THE PETITIONER IN THIS CASE WILL NOT HAVE THE EFFECT OF EXTENDING THE TYPE "F" REORGANIZATION TO A GREAT NUMBER OF CORPORATE REORGANIZATIONS.

The "unintended difficulties" argument of the Tax Court seems to carry an underlying premise that should Petitioner prevail, there would be no end to the application of Section 368(a)(1)(F) to a large variety and number of corporate reorganizations. This is not correct. A favorable decision in this case within the guidelines herein discussed would limit the type "F" reorganization to cases where the reorganization meets the following requirements:

1. No substantial shift in assets or ownership.

2. A "continuity of interest" as to the assets, ownership, and business enterprise after the merger.

3. Satisfaction of the "form vs. substance" test as to the *economic effect* of the reorganization.

Petitioner submits that these facts will not be found in large numbers of corporate reorganizations. Petitioner further submits that this was exactly what Congress had in mind when it singled out the Type "F" reorganization for special treatment, as with reference to loss carrybacks. The intent was not to *penalize* the taxpayer by reason of the form of reorganization selected, where in substance the same business or businesses are continuing in altered form.

XIII.

THE FINDING OF THE TAX COURT THAT THE TWO CORPORATIONS HERE INVOLVED, ASSOCIATED MACHINE SHOP AND J & M ENGINEERING, WERE COMPLETELY SEPARATE AND DISTINCT ENTITIES ENGAGED IN ACTIVE CONDUCT OF SEPARATE BUSINESSES, IS CLEARLY ERRONEOUS AND CONTRARY TO OTHER TAX COURT DECISIONS.

In its opinion, (Record, Volume I, pp. 84, 93, 95) the Tax Court finds that the two pre-existing corporations were completely separate and distinct entities, each carrying on a separate and distintc business. Quite to the contrary, the record (Volume II, pp. 44-59) indicates the following:

1. J & M Engineering, although formed to operate a separate sheet metal business, was never able to do so successfully.

2. In fact, J & M Engineering operated a machine shop business indistinguishable from that carried on by Associated Machine Shop.

3. Most of the machine shop work carried on by J & M was for the account of Associated Machine Shop, on orders produced by Associated Machine Shop, or for customers of Associated Machine Shop.

4. The equipment used by J & M Engineering included substantial amounts transferred over from Associated Machine Shop.

5. J & M Engineering did not advertise or even maintain a telephone service under its own name.

6. Associated Machine Shop provided all office, administrative, and accounting services for J & M *without cost* to J & M.

7. The Union did not even recognize J & M as a separate entity for collective bargaining and contract purposes.

8. The articles of incorporate, by-laws, directors and officers of the two corporations were substantially identical.

In view of the above facts, how can it be said that these were two separate and distinct entities carrying on separate and distinct businesses? The statement of facts relied upon by the Tax Court are not in accord with the record. For example, while the Tax Court points out that J & M Engineering was organized to carry on a sheet metal business, it *does not* point out that the sheet metal business was not great enough to support the corporation, and that the *majority* of its activity was devoted to machine shop work *identical* to that carried on by Associated Machine Shop. While the Tax Court points out (Record, Volume I, p. 93) that J & M had its own customers and contracts, it *does not* point out that by far the greatest volume of its work came through Associated Machine Shop, directly or indirectly.

In its findings (Record, Volume I, pp. 83-84), the Tax Court emphasizes several facts, including the maintenance of separate bookkeeping and accounting records; purchases and sales in separate names; separate payrolls; and the maintenance of separate corporate seals, minute books, stock registers and bank accounts. Reliance on such facts is *totally inconsistant* with prior cases in which the Tax Court said these same factors should be *disregarded* in determining whether or not the corporations were engaged in separate business activity. The best example is *Aldon Homes, Inc. v. Commissioner,* 33 T.C. 582 (1959), which also involved brother-sister corporations. All of the above factors were present in that case, yet the Tax Court held there were no separate business activities. The following language is particularly significant (pp. 600-601):

> "Holding corporate meetings, adopting by-laws, electing officers and directors, and issuing stock and other securities, though necessary steps in preparation for the carrying on of business activities, were merely formal acts of organization and were not substantive income-producing activities. Nor did the keeping of seperate books for each of the corporations, of itself, constitute such business activity. . . . Their original incorporators were identical and their articles of incorporation and minutes of meetings were substantially identical. . . ."

In summary, the Tax Court and for that matter, this Court (*British Motor Car Distributors, Ltd. v. Commissoner,* (C.A. 97A, 1960) 278 F. 2d 392; *Shaw Construction Co. v. Commissioner,* (C.A. 9th, 1960)

323 F. 2d 316) have generally recognized that the status of separate corporate entities should be equated in terms of *economic realities*, not *formal requirements*. Petitioner submits that an application of this same line of reasoning to Petitioner's case clearly discloses the fallicy of the findings of the Tax Court.

XIV.

THE APPLICATION OF THE ALTER EGO DOCTRINE, AS SUGGESTED BY THE FIFTH CIRCUIT IN DAVANT AND THE FOURTH CIRCUIT IN PRIDEMARK, WOULD REQUIRE A DECISION IN THIS CASE FAVORABLE TO THE PETITIONER.

In the *Davant* opinion, the Fifth Circuit made a specific reference to the *alter ego* doctrine as a basis for its decision. Similary, in *Pridemark v. Commissioner*, 345 F. 2d 35 (C.A. 4th, 1965) the Fourth Circuit, at page 42, stated that the application of Section 368(a)(1)(F) ". . . is limited to cases where the corporate enterprise continues uninterrupted . . ." and ". . . there is a mere change of corporate vehicles, the transferee being no more than the *alter ego* of the transferor."

Alter ego is, of course, a term of special significance in corporation law with reference to disregarding a separate corporate entity to prevent fraud or injustice. In *Fisser v. International Bank*, (CA 2d, 1960) 282 F. 2d 231, at page 234, the Court said:

> ". . . it is clear that the consequence of applying the alter ego doctrine is that the corporation and those who have controlled it without regard to its separate entity are treated as but one entity, and at least in the area of contracts, the acts of one are the acts of all."

It is reasonable to infer that in using the term *alter ego* in *Pridemark*, the Court of Appeals was using it to mean that the surviving corporation in a type (F) reorganization must be in substance the same business (as opposed to legal) entity as its predecessors. In the last section of this argument, Petitioner pointed out that the facts of this case relating to the organization, operation, and merger of Associated Machine Shop, J & M Engineering, and Associated Machine *clearly* indicate that there was only one business entity involved.

The California Corporate Securities Law, Title 4, Division 1 of the California Corporations Code, provides strict regulation of the sale and issuance of securities of California corporations, requiring issuing corporations to obtain permits from the California Commissioner of Corporations. This authority and restriction extends to the issuance and exchange of shares in statutory mergers. California Administrative Code, Title 10, Section 759. Yet, although the California of Corporations has extended his authority to the point of requiring a permit to be obtained by a foreign corporation to change only the voting rights of outstanding shares in *Western Airlines, Inc. v. Sobieski* 12 Cal. Rptr. 719 (1961), he *did not* require a permit for the issuance and exchange of shares in this merger

(Exhibit 8-H). Thus, the California Commissioner of Corporations did not give recognition to the separate legal entities.

Insofar as the tax law is concerned, the legal doctrine of *alter ego* is more closely identified with the multiple corporation problem, where the concept of one taxable entity in substance as opposed to two or more entitles in form is well recognized. *Aldon Homes, Inc.*, 33 T.C. 582 (1959), applied Section 61(a) of the 1954 Internal Revenue Code to tax the income of several corporations to one entity, upholding the contention that the various corporations were not "tax worthy" entities and "lacked substance and realty." The term "one taxable entity" was applied by this Court in an earlier case where there were four separate legal entities "in form." *Advance Machinery Exchange, Inc.*, (T.C. Memo 1949) 8 T.C.M. 84, affirmed *Advance Machinery Exchange, Inc. v. Comm.* (CA 2d, 1952) 196 F. 2d 1006, cert. den. (1952) 344 U.S. 835. Congress adopted the "single entity" approach with the enactment in 1964 of the new multiple corporation provisions, Sections 1561, 1562, and 1563. The two predecessors of the Petitioner clearly would have constituted a "brother-sister controlled group" under Section 1563(a); and, therefore, would have been entitled to only one surtax exemption.

Under either an *alter ego* or single taxable entity approach, this reorganization should qualify under Section 368(a)(1)(F).

CONCLUSION

Based upon all of the foregoing, Petition submits that the decision of the Tax Court in this case was based upon a rule of convenience, not upon a sound analysis and interpretation of the law, and should be reversed by this Court.

Respectfully submitted,

JERRY A. KASNER,
Attorney for Petitioner.

Certification

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinon, the foregoing brief is in full compliance with those Rules.

Jerry A. Kasner,